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JAPANESE INVESTMENT IN U.S. REAL ESTATE

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ABOUT THIS STUDY

In the last year or so, the business press has paid increasing attention to investment by Japanese organizations in real estate in the United States.

As a special feature of the Cushman & Wakefield Business America Real Estate Monitor, Louis Harris and Associates conducted a highly targeted, qualitative study of Japanese investment in U.S. real estate, based on 45 interviews with investment decisionmakers at prominent Japanese corporations. Selected for inclusion in the study were the largest organizations in industry categories deemed likely to make investments of this kind.

Fieldwork for the study was conducted in Japan from August 31 through October 30, 1987. Thus, of the 45 interviews that form the basis of the study, 30 were completed prior to the stock market plunge of October 19, 1987, and 15 afterwards. Although some variation in response was noted before and after the financial markets crisis, no consistent pattern has emerged which would indicate that the Japanese attitude and approach toward U.S. real estate has changed. Indeed, the findings show that Japanese participation in the U.S. real estate market has a conservative and long-term flavor.

Of the 45 interviews, 33 are with organizations that have invested in U.S. real estate in the last five years, while 12 are with organizations that have not. The study reveals that growth of Japanese investment in U.S. real estate will take place among those organizations already here; those organizations not already holding U.S. real estate are not likely to begin doing so in the near future. For that reason, the findings presented here focus on organizations that <u>have</u> invested in the past five years -- their goals, priorities, location preferences, use of financing vehicles, dealings with intermediaries.

All interviews were conducted in person.

HIGHLIGHTS

- Current Japanese investors in U.S. real estate consider it their most important kind of investment in this country, in the context of their investment portfolio overall. This holds true both for today and for the two-year outlook, with a modest increase in importance expected for the near future. What's more, a majority expect their U.S. real estate investments to increase at least "somewhat" over the next year in terms of funds invested, and an even larger majority expect to see some kind of increase over the next two years.

- The growth of Japanese investment in U.S. real estate will most likely take place among those organizations that are already in the market. Large institutions that do not already have holdings in U.S. real estate are unlikely to begin doing so in the near future.

- Japanese participation in the U.S. real estate market has a conservative and long-term flavor. Preservation of capital, along with high yields and capital growth, are the primary goals, and these are also the criteria on which current investors give their best ratings of U.S. real estate investments.

- Office buildings head the list of types of properties held, both for today and for two years from now. But decisionmakers in Japanese organizations that have already invested in U.S. real estate expect investments in stores, shopping centers, and malls to grow and investments in land zoned for commercial use to diminish. The decreasing appeal of land for commercial development reflects a feeling that the market is overbuilt and an aversion to leasing risks in the U.S.

- The Northeast is the most appealing region for real estate investment; the West is also attractive. Good real estate values and a good return on investment are the main reasons.

- Los Angeles, New York, and Washington, D.C., head the list of locations where organization currently hold real estate investments; but the findings indicate that interest in these areas may have peaked. The up-and-coming markets appear to be Boston, Atlanta, and Philadelphia.

- Japanese investors view the United States real estate market as wide-open, deep, and offering a good return on

their investment. Foreign exchange differentials, the availability of prestigious properties, opportunities to be involved in construction, the availability of knowledgeable brokers, and a broad array of financing vehicles are seen as far less important reasons for investing in U.S. real estate.

- Indirect financing vehicles such as syndications and participating debt financings will be used more frequently in the next two years, according to the findings.

- A little more than half of Japanese investors in U.S. real estate report they have "always" or "very often" used intermediaries or brokers in their approach to the market up to now, and this pattern is expected to continue for the next two years. Topping the list of qualities investors look for in U.S. brokers is honesty and integrity, followed by responsiveness and follow-through in finding the best possible U.S. real estate investments.

THE FINDINGS

The Context of Offshore Investment for Japanese Organizations

Among Japanese organizations that have invested in U.S. real estate in the last five years, nearly all of the decisionmakers consider offshore investments to be at least "somewhat important" in their overall investment portfolio today and expect this to be so two years from now as well. And the level of importance is expected to increase; just less than half of the decisionmakers say offshore investment is "very important" today, but this proportion rises to over three in five who predict offshore investment will be "very important" in two years.

What about offshore investments specifically in real estate? This too is expected to increase modestly in importance, with just over one-third saying it is "very important" today increasing to somewhat less than one-half saying it will be "very important" two years from now. In terms of funds invested, a majority expect an increase in offshore real estate investments both in the next year and the next two years, with the number anticipating a great increase growing from a little over one in seven in the next year to nearly one in four two years from now, and the number predicting a decrease dropping from over one in ten to nothing.

Current investors in U.S. real estate also hold real estate in other countries, with over three in five reporting they do so. Above all, holdings are noted in Hong Kong, the U.K., and Australia.

Organizations that have not invested in U.S. real estate in the past five years also predict offshore investments will become more important in their context of their overall portfolio in the next two years, but the importance of

offshore real estate is actually seen as declining overall (despite a rise in the number who think it will be "very important" in two years).

Real Estate Investments in the U.S.

Returning to Japanese organizations that have invested in U.S. real estate in the past five years, real estate is considered much more important than five other kinds of investment in the U.S. both for today and for the two-year forecast (Table 1). Nearly three in five decisionmakers rate investments in U.S. real estate as "very important" today in the context of their organization's investment portfolio overall, while more than three in five expect it to be "very important" two years from now. Nearly three in five decisionmakers rate investments in U.S. real estate as "very important" today in the context of their organization's investment portfolio overall, while more than three in five expect it to be "very important" two years from now. The next type of U.S. investment as ranked by importance is government bonds, running a far distant second with about one-quarter of decisionmakers deeming them "very important" both today and two years from now. No other type of investment in the U.S. -- corporate stocks, corporate bonds, other corporate debt instruments, or mortgage-backed securities -- is considered "very important" today by as many as one-tenth of these decisionmakers whose organizations have invested in U.S. real estate in the past five years. Of these, only stocks are seen as likely to increase in importance in the next two years, with just under one in five predicting they'll be "very important" at that time.

A majority of just under three in five current investors expect to see an increase in their organizations' real estate investments in the U.S. over the next year, and nearly two-thirds anticipate an increase in the next two years.

Among organizations that have not invested in U.S. real estate in the past five years, a majority aren't "very" or "at all likely" to begin looking into such investments in the next two years -- for the most part they're "not at all likely." Of the five decisionmakers who say their organizations are "very" or "somewhat likely" to do so, not one ventures that his organization is "very likely" to actually invest in U.S. real estate in the next two years -- all are only "somewhat likely" to do so. The conclusion is that corporations that have not invested in U.S. real estate thus far are not likely prospects for such investments in the near future. Government bonds are clearly the leading U.S. investment for this group for both today and two years from now.

Q.1g, 1h

Table 1

U.S. REAL ESTATE INVESTMENTS "VERY IMPORTANT"
TODAY AND TWO YEARS FROM NOW

Base: Have invested in U.S. real estate in last five years (33)

	Today %	Two Years From Now %
Real estate	58	64
Government bonds	24	24
Corporate stocks	9	18
Corporate bonds	6	9
Mortgage-backed securities	6	6
Corporate debt investment other than bonds, such as commercial paper	6	6

What Kinds of U.S. Real Estate?

Above all, Japanese investors in U.S. real estate today hold office buildings and office complexes -- reported by two-thirds of the decisionmakers. Tying for a distant second place today -- with just under one-half reporting they hold them -- are land zoned for commercial use and hotels (Table 2). Residential properties such as houses, apartment buildings, and condominiums follow closely in third place. Following distantly with about one-quarter naming each are land zoned for residential use, stores, shopping centers, and malls, and warehouse, manufacturing, and distribution facilities, while recreational facilities are reportedly held by about one in five.

Looking ahead two years, office buildings and complexes still head the list, again with about two-thirds of the decisionmakers predicting it's "very" or "somewhat likely" they'll be making such investments at that time. Just over half of the decisionmakers consider it "very" or "somewhat likely" they'll be investing in hotels, while just under half expect to hold residential properties. Nearly two in five expect to invest in stores, shopping centers, and malls, while about one-third are at least "somewhat likely" to invest in land zoned for residential or commercial use. Just under three in ten foresee investments in recreational facilities, and about one-fourth investments in warehouse, manufacturing, and distribution facilities.

All in all, investments in office buildings as well as in residential properties and warehouse, manufacturing, and distribution facilities may be expected to remain at about the same level in two years' time. But according to decisionmakers in Japanese organizations that already have invested in U.S. real estate, holdings in stores, shopping centers, and malls will grow while investments in land zoned for commercial use will diminish. The decreasing appeal of

land for commercial development reflects a feeling that the market is overbuilt and an aversion to leasing risks in the U.S. Smaller increases are indicated for residentially-zoned land, hotels, and recreational facilities.

Q.5a, 5b

Table 2

KINDS OF PROPERTIES INVESTED IN TODAY AND IN TWO YEARS

Base: Have invested in U.S. real estate in last five years (33)

	Hold Today %	Likely* To Invest In Two Years %	Difference
Office buildings and complexes	67	67	-
Hotels	48	54	+6
Land zoned for commercial use	48	33	-15
Residential properties such as houses, apartment houses, and condominiums	45	48	+3
Land zoned for residential use	27	36	+9
Stores, shopping centers, and malls	24	39	+15
Warehouse, manufacturing, and distribution facilities	24	24	-
Recreational facilities	21	27	+6
Research and development facilities	6	9	+3
Agricultural land and facilities	3	6	+3

*"Very" or "somewhat likely."

Location Preferences

Speaking in terms of broad regions, just over half of current Japanese investors in U.S. real estate see the Northeast as most appealing for investment, while just over one-quarter say the West. Fewer than one in ten nominate the South, the Midwest, or Hawaii as the most appealing region, while no one at all names the Southwest or Alaska.

Good real estate values and a good return on investment are the main reason for a region's attractiveness for real estate investment. Familiarity with the area is also an important reason for Japanese investors to find a region appealing. Cultural or economic ties with Japan, and being an area in which they already do business, are also pluses.

The findings for specific real estate investment locations in the U.S. seem to indicate that interest in the Los Angeles and New York areas, as well as in the Washington, D.C., area, may have peaked (Table 3). The up-and-coming markets appear to be Boston, Atlanta, and Philadelphia. Investment in Chicago and San Francisco is likely to hold steady.

Los Angeles heads the list of locations where organizations currently hold real estate investments -- named by two-thirds of Japanese investors. New York follows with just under one-half. Washington, D.C., Chicago, and San Francisco are cited by about one in four investors as locations where they currently have holdings, and about the same number volunteer Hawaii. San Diego and Dallas-Fort Worth are each named by just over one in seven, while Boston is cited by about one in eight. Asked where their organizations are likely to invest in the next two years, just over one-third each say New York and Los Angeles, and one-third say Boston. Just over one-quarter each say Chicago and San Francisco, and just under one-quarter say Atlanta, just under two in five each say Philadelphia and Washington, one in seven volunteer Hawaii, and one in eight say San Diego.

Those who have not invested tend to see the Northeast as the most attractive region for investment, again because of the real estate values there and the perception that it offers good return on investment.

Q.10a, 10b

Table 3

LOCATIONS FOR U.S. REAL ESTATE INVESTMENTS

Base: Have invested in U.S. real estate in last five years (33)

Area:	Currently Invest %	Expect To Invest %
Los Angeles	67	36
New York	48	36
Washington, D.C.	27	18
Chicago	24	27
San Francisco	24	27
Hawaii	24	15
Dallas-Fort Worth	15	6
San Diego	15	12
Boston	12	33
Atlanta	9	24
Portland, Oregon	9	3
Miami	6	6
Baltimore	6	3
Seattle	6	3
Philadelphia	3	18
Detroit	3	6
Houston	3	3
Minneapolis/St. Paul	3	6
Phoenix	3	6
Cincinnati	3	-

(Continued)

Q.10a, 10b

Table 3 (Continued)

LOCATIONS FOR U.S. REAL ESTATE INVESTMENTS

Base: Have invested in U.S. real estate in last five years (33)

Area:	Currently Invest %	Expect To Invest %
Kansas City	3	-
Norfolk	3	3
Sacramento	-	3
Other	6	-
None	3	6

Investment Goals

When it comes to investing in U.S. real estate, Japanese organizations take a nonspeculative, conservative approach. Their goal above all else is preservation of capital, but high yields and capital growth are also important (Table 4). Each of these three goals is considered "absolutely essential" or "very important" by about four in five investors, with nearly two in five considering preservation of capital "absolutely essential." Downside risk coverage and portfolio diversification merit some consideration, with both deemed at least "very important" by half of the investors. Prestige and visibility, in and of themselves, are not much of a factor when Japanese organizations select U.S. properties for investment.

In rating U.S. real estate investments on these criteria today, Japanese investors give the best marks on yields, preservation of capital, growth of capital, and portfolio diversification, with a majority saying U.S. real estate investments are "excellent" or "pretty good" on each. Fewer than half give positive marks for prestige and visibility today, while only a little over one-quarter do so on downside risk coverage.

The ratings are similar for the two-year outlook. Yields come in first, with nearly seven in ten predicting they'll be at least "very good." Growth of capital, portfolio diversification, and preservation of capital come in next, each with about three in five saying U.S. real estate investments will be good on that in two years. Again, smaller percentages expect U.S. real estate investments to stack up positively on prestige and visibility and on downside risk coverage.

While noninvestors in U.S. real estate are loathe to say any investment goal is "absolutely essential," they see portfolio diversification as the most important criterion. Interestingly, this is the criterion on which they rate U.S. real estate investments best.

Q.2a, 2b, 2c

Table 4

INVESTMENT GOALS: IMPORTANCE AND
RATING OF U.S. REAL ESTATE INVESTMENTS

Base: Have invested in U.S. real estate in last five years (33)

	Absolutely Essential	U.S. Real Estate Investments "Excellent" or "Very Good"	
		Today	Two Years From Now
	%	%	%
Preservation of capital	39	57	57
Growth of capital	21	54	61
High yields	15	61	67
Prestige and visibility	6	45	48
Portfolio diversification	3	51	61
Downside risk coverage	3	27	30

Reasons for Investing in U.S. Real Estate

Japanese investors in U.S. real estate see above all a wide-open and deep market offering good return on their investment (Table 5).

Nearly two-thirds cite good return on investment and ample opportunities for real estate investment as "very important" reasons for an organization such as theirs to invest in U.S. real estate today. These two reasons head a list of eight. No other reason tested is deemed "very important" by a majority, but just under half see opportunities to invest in different kinds of properties as a "very important" reason. Far fewer, about one in five, see foreign exchange differentials, opportunities to invest in large, prestigious properties, or opportunities to be involved in construction as "very important," while just over one in ten say the same for the availability of knowledgeable brokers or a broad array of real estate financing vehicles in the U.S.

The lineup of reasons for investing in U.S. real estate two years from now is much the same as it is today.

Standing out as reasons for not investing in U.S. real estate today are the rising value of the yen relative to the dollar, the fast pace of decisionmaking required to participate in the U.S. real estate market, and -- as has been mentioned in connection with a finding reported earlier -- the risks of leasing properties in the U.S. market. Each of these is considered "very important" by roughly one in five. Interestingly, having to deal with regulations on foreign investment through Japan's Ministry of Finance (MOF) is overwhelmingly seen as "not a reason at all" why organizations might not want to invest.

A good return on investment is the most important reason current noninvestors would give for investing in U.S. real estate, followed by the availability of knowledgeable brokers. For noninvestors, having to deal with MOF regulations is the most important reason they would not want to invest.

Q.3a

Table 5

"VERY IMPORTANT" REASONS FOR INVESTING
IN U.S. REAL ESTATE TODAY

Base: Have invested in U.S. real estate in last five years (33)

	Total %
A good return on investment	64
Ample opportunities for real estate investment	64
Opportunities to invest in different kinds of properties	45
The strengths or weaknesses of the U.S. economy relative to Japan's, e.g., foreign exchange differentials	21
Opportunities to invest in or own large, prestigious properties that would reflect well on your organization	18
Opportunities to be involved in the construction business	18
The availability of knowledgeable brokers and intermediaries in the U.S. who are ready, willing, and able to assist Japanese organizations acquire and manage U.S. properties	12
The availability of a broad array of real estate financing vehicles in the U.S.	12

Financing Vehicles

If the broad array of financing vehicles in the U.S. is not considered a "very important" reason for investing in U.S. real estate, Japanese investors nonetheless express a high level of familiarity with those vehicles. Majorities are "very familiar" with six of the seven vehicles tested. Highest on the list are conventional debt financing and joint ventures, both "very familiar" to roughly two-thirds of decisionmakers with U.S. real estate investments. Nearly three in five are "very familiar" with sale-leasebacks, and over half with publicly- and privately-offered syndications and participating and/or convertible debt financings. Less than -- but nearly -- half are "very familiar" with alternative financing techniques such as zero coupons, bowties, swaps, credit enhancements, and debt with equity warrants.

The findings on which financing vehicles investors use today and expect to be using in the next two years suggest a slight downturn in conventional debt financing and joint ventures and a sharp rise in indirect investments such as syndications and participating debt financings, in which responsibility for managing the investment is shared or passed on entirely, and which offer substantially lower risk (as well as lower yield) (Table 6). To be sure, conventional debt financing leads the list of vehicles investors expect to use two years out as well as the list of vehicles they have used up to now, and joint ventures occupies second place now and two years from now. But while nearly two-thirds have used conventional debt financing up to now, fewer than three in five expect to do so in the next two years, and joint ventures likewise drop from nearby three in five to just over half. Meanwhile, the use of publicly-offered syndications is expected to increase from less than one in ten using them today to more than one in five in two years; privately-offered syndications from less than one in five today to one-third in two years; sale-

leasebacks from a little over one in ten to just under two in five. Moreover, the use of all of the alternative financing techniques tested except bowties is expected to increase.

Majorities of current noninvestors claim they are "very familiar" with joint ventures and conventional debt financing and at least "somewhat familiar" with every other financing vehicle tested.

Q.7b, 7c

Table 6

USE OF FINANCING VEHICLES

Base: Have invested in U.S. real estate in last five years (33)

	Today %	In Next Two Years %
Conventional debt financing	64	58
Joint ventures	58	52
Privately-offered syndications	18	33
Sale-leasebacks	12	39
Zero coupons	12	18
Publicly-offered syndications	9	21
Swaps	9	21
Debt with equity warrants	9	12
Participating and/or convertible debt financings	9	39
Credit enhancements	-	6
Other vehicles	9	3
None	15	6
Not sure	3	9

The Use of U.S. Management Organizations

Majorities or pluralities of those who hold investments today in seven out of the ten types of U.S. real estate tested retain management firms in the U.S. to manage the property. Those types of property are agricultural land and facilities, hotels, office buildings, commercially-zoned land, stores and shopping centers, residentially-zoned land, and recreational facilities. For the other three kinds of property -- R & D facilities, residential properties such as houses and apartment buildings, and warehouse, manufacturing, and distribution facilities -- U.S. investors are just as likely to manage the property themselves as to use U.S. management.

Two years from now, majorities or pluralities of those who say they are likely to hold investments in nine out of the ten types of real estate predict their organizations will be more likely to retain U.S. management than to manage those properties themselves.

The Use of Brokers or Intermediaries

A little more than half of Japanese investors in U.S. real estate report they have "always" or "very often" used intermediaries or brokers in their approaches to the market up to now; just less than half say they have done so "only sometimes" or "never." For the next two years, over half again predict they'll "always" or "very often" be using a broker.

What are the essentials Japanese investors look for in a broker or intermediary? First on the list is the broker's honesty and integrity -- considered "absolutely essential" by a third of current investors and at least "very important" by nearly nine in ten. Next comes "responsiveness and follow-through in finding the best possible U.S. real estate investments for an organization such as yours" -- deemed "absolutely essential" by about one-

quarter and again at least "very important" by close to nine in ten. The "ability to provide timely information on prospective investments in full detail" is considered "absolutely essential" by nearly one in five, but again at least "very important" by nearly nine in ten. Other criteria are seen as having far less importance.

How would they rate most U.S. brokers or intermediaries on these criteria? Not one Japanese investor gives U.S. brokers "excellent" marks on honesty and integrity, their most important criterion; fewer than one in five rate them "very good" and nearly three-quarters say they're "only fair" or "poor." U.S. intermediaries score slightly better on responsiveness and follow-through, although again no one says they're "excellent"; over half say they're "very good" on this dimension while over a third say "only fair" or "poor." Similar ratings are given on ability to provide timely information on prospective investments in full detail; no one rates U.S. brokers "excellent," but three in five say "very good" and three in ten say "only fair" or "poor."

Like current investors, noninvestors would consider a broker's honesty and integrity to be of the utmost importance, followed by responsiveness and followthrough. And from what they know or have heard, they see U.S. brokers as being no better than "only fair" on either.

HOW THE STUDY WAS CONDUCTED

The findings presented in this report derive from a qualitative study based on 45 in-person interviews with investment decisionmakers at prominent Japanese business organizations. Selected for inclusion in the study were the largest organizations in each of twelve industry categories deemed likely to make investments in U.S. real estate. This industry-specific design was meant to target relevant organizations within a much larger list of Japanese business entities overall and to insure inclusion of relevant organizations that might not be large enough to appear on a more exclusive list of the very largest Japanese corporations. The industry categories -- and the largest companies within each of them -- are drawn from the Japan Company Handbook:

-- Construction

-- Real estate

-- Life insurance

-- Nonlife insurance

-- Miscellaneous financing

-- Long-term credit banks

-- Securities firms

-- Trust banks

-- City banks

-- Airlines

-- Railroads

-- Commerce companies

In addition, a handful of respondents were selected from a "miscellaneous" category of companies potentially active in the U.S. real estate market

but not included in the size ranked lists in each of the categories listed above.

Fieldwork for the study was conducted in person in Japan from August 31 through October 30, 1987.